



# ICLG

The International Comparative Legal Guide to:

## Securitisation 2015

**8th Edition**

A practical cross-border insight into securitisation work

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## EDITORIAL

Welcome to the eighth edition of *The International Comparative Legal Guide to: Securitisation*.

This guide provides the international practitioner and in-house counsel with a comprehensive worldwide legal analysis of the laws and regulations of securitisation.

It is divided into two main sections:

Five general chapters. These are designed to provide readers with a comprehensive overview of key securitisation issues, particularly from the perspective of a multi-jurisdictional transaction.

Country question and answer chapters. These provide a broad overview of common issues in securitisation laws and regulations in 38 jurisdictions.

All chapters are written by leading securitisation lawyers and industry specialists and we are extremely grateful for their excellent contributions.

Special thanks are reserved for the contributing editor, Mark Nicolaides of Latham & Watkins LLP, for his invaluable assistance.

Global Legal Group hopes that you find this guide practical and interesting.

The *International Comparative Legal Guide* series is also available online at [www.iclg.co.uk](http://www.iclg.co.uk).

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## 1 Receivables Contracts

- 1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller: (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?**

With the exception of certain debts arising under regulated consumer credit arrangements and contracts for sale of land (or interests therein), debts need not be in writing to be enforceable against obligors. Contracts may be written, oral, or partly written and oral provided the key elements to form a contract coincide. An invoice may itself represent, or evidence a debt arising pursuant to, a contract between parties. Where a contract is oral, evidence of the parties' conduct is admissible to ascertain the terms of such contract. A contract may also be implied between parties based on a course of conduct or dealings where the obligations arising from the alleged implied contract are sufficiently certain to be contractually enforceable.

- 1.2 Consumer Protections. Do the laws of England & Wales: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?**

- a) Consumer credit loans are regulated by the Financial Services and Markets Act 2000 (**FSMA**) and the Consumer Credit Act 1974 (the **CCA**). The Financial Conduct Authority (the **FCA**) introduced a ‘cap’ on interest and other charges levied by lenders under high-cost short-term loans (broadly, unsecured credit agreements where the borrower must repay, or substantially repay, credit advanced within a maximum of 12 months from such advance and for which the annualised percentage rate of interest is 100% or more). This ‘cap’ on the cost of credit for such loans has three components:
- i) ‘total cost cap’: the total interest, fees and charges payable by the borrower must not exceed 100% of the amount borrowed;
  - ii) ‘initial cost cap’: interest and other charges payable by the borrower must not exceed 0.8% per day of the outstanding principal during the agreed loan duration and any refinancing; and
  - iii) ‘default fee cap’: default fees must not exceed £15.

- b) There is a statutory right to interest on late payments, but this does not apply to consumer credit agreements.
- c) Borrowers pursuant to regulated consumer credit agreements (under the **CCA**) may cancel the credit agreement up to 14 days from execution.
- d) Certain clauses of receivables contracts may be deemed unfair under the Unfair Terms in Consumer Contracts Regulations 1999 (the **UTCCR**) and therefore unenforceable against the consumer. The Consumer Protection from Unfair Trading Regulations also prohibit certain practices that are deemed unfair.

On 1 April 2014, the FCA became responsible for consumer credit regulation in the UK. The FCA's consumer credit sourcebook (known as ‘CONC’) sets out important protections for consumers with which authorised persons must comply.

Under FSMA, the FCA may render contracts unenforceable if they are: (i) made in respect of certain credit-related regulated activities (including servicing) other than in accordance with appropriate FCA permissions (unless subject to a ‘validation’ order from the FCA which is available in certain limited circumstances); and (ii) made in contravention of its product intervention rules or cost and duration of credit agreement rules.

- 1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?**

Not specifically, although there may be enforcement issues due to laws pertaining to sovereign immunity.

## 2 Choice of Law – Receivables Contracts

- 2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in England & Wales that will determine the governing law of the contract?**

For contracts entered into on, or after, 17 December 2009, the position is governed by Regulation 593/2008/EC of 17 June 2008 (**Rome I**). For contracts entered into prior to 17 December 2009, a different regime applied.

Under Rome I, absent a choice of governing law by the parties, and subject to specific rules governing contracts of carriage, consumer contracts, insurance contracts and individual employment contracts,

the law governing the contract is determined in four stages. First, Rome I sets out rules in relation to specific types of contracts. For example, that a contract for the sale of goods is governed by the law of the country where the seller has his habitual residence. Secondly, if the governing law cannot be determined by reference to the specific rules, then the contract is governed by the law of the country where the party required to effect the characteristic performance of the contract has his habitual residence. However, if it is clear that the contract is manifestly more closely connected with a country other than that determined in accordance with the first two stages, then the law of that other country applies. Finally, if the governing law is not determined by the first three stages, then the contract is governed by the law of the country with which the contract is most closely connected.

**2.2 Base Case. If the seller and the obligor are both resident in England & Wales, and the transactions giving rise to the receivables and the payment of the receivables take place in England & Wales, and the seller and the obligor choose the law of England & Wales to govern the receivables contract, is there any reason why a court in England & Wales would not give effect to their choice of law?**

No, there is not.

**2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in England & Wales but the obligor is not, or if the obligor is resident in England & Wales but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in England & Wales give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?**

Rome I stresses the importance of the parties' freedom to choose the law of their contract (including a foreign law). This choice can be express or implied. However, Rome I restricts the effect of the parties' choice: (i) where all elements relevant to the contract (other than the choice of law) are located in a country other than the country whose law has been chosen by the parties and that country has rules which cannot be derogated from by agreement (in which case the court will apply those rules); (ii) where all elements relevant to the contract (other than the choice of law) are located in one or more EU Member States, the parties' choice of applicable law other than that of a Member State shall not prejudice the application of provisions of EU law, which cannot be derogated from by agreement; (iii) to the extent that the law chosen conflicts with overriding mandatory rules of English law (as the law of the forum); (iv) where the applicable foreign law is manifestly incompatible with English public policy; or (v) where the overriding mandatory rules of the country where the obligations arising out of the contract have to be or have been performed render performance of the contract unlawful.

**2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in England & Wales?**

No, it is not.

### 3 Choice of Law – Receivables Purchase Agreement

**3.1 Base Case. Does the law of England & Wales generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e. the laws of England & Wales or foreign laws)?**

As discussed above, under Rome I (subject to the limited exceptions described in question 2.3) the parties to a contract are free to agree that the contract be governed by the law of any country, irrespective of the law governing the receivables. The law governing the sale agreement, together with mandatory rules of the jurisdiction of the relevant forum and/or the country where the contract is performed, will govern the effectiveness of the sale between the seller and the purchaser, whilst the governing law of the receivables will govern perfection of that sale and the relationship between the purchaser and the underlying obligor.

**3.2 Example 1: If (a) the seller and the obligor are located in England & Wales, (b) the receivable is governed by the law of England & Wales, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of England & Wales to govern the receivables purchase agreement, and (e) the sale complies with the requirements of England & Wales, will a court in England & Wales recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?**

In general, it will. However, as noted at question 2.3 above, there are limited circumstances where certain legal provisions of countries other than the country whose law was selected to govern the receivables purchase agreement may (but need not) be taken into account by English courts. For example, as noted in part (v) of the answer to question 2.3 above, the court may give effect to overriding mandatory rules of the jurisdiction in which the purchaser is located if such rules render unlawful the performance of obligations under the contract which are to be performed in that foreign jurisdiction.

**3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside England & Wales, will a court in England & Wales recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor's country or the purchaser's country (or both) be taken into account?**

See questions 3.1 and 3.2 above. The court would respect the parties' choice of law to govern the receivables purchase agreement, subject to the restrictions noted at question 2.3 above. As noted above, the court may give effect to overriding mandatory rules of the jurisdiction in which the obligor or the purchaser or both are located if such rules render unlawful the performance of obligations under the contract which are to be performed in such foreign jurisdiction(s).

- 3.4 Example 3: If (a) the seller is located in England & Wales but the obligor is located in another country, (b) the receivable is governed by the law of the obligor's country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor's country, will a court in England & Wales recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with the sale requirements of England & Wales?**

In assessing the validity of the receivables purchase agreement as between the seller and the purchaser, the English courts would apply the law of the receivables purchase agreement (in this case, the law of the obligor's country) and as to the perfection of the sale, the governing law of the receivables (in this case, also the law of the obligor's country). However, as discussed in question 2.3 above, certain mandatory principles of the law of England & Wales (such as mandatory principles of insolvency law in the seller's insolvency) would not be capable of disapplication by the parties' choice of a foreign law. Further, the courts would not apply the parties' choice of a foreign law to the extent it conflicted with those mandatory principles, or was manifestly incompatible with public policy.

- 3.5 Example 4: If (a) the obligor is located in England & Wales but the seller is located in another country, (b) the receivable is governed by the law of the seller's country, (c) the seller and the purchaser choose the law of the seller's country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller's country, will a court in England & Wales recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with the sale requirements of England & Wales?**

See questions 3.1 and 3.4 above. The English courts would recognise the sale as effective against the obligor as it complies with the requirements of the law governing the receivable (in this case the law of the seller's country).

- 3.6 Example 5: If (a) the seller is located in England & Wales (irrespective of the obligor's location), (b) the receivable is governed by the law of England & Wales, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser's country, will a court in England & Wales recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in England & Wales and any third party creditor or insolvency administrator of any such obligor)?**

See questions 3.1 to 3.5 above. The sale would be effective against the seller provided it complied with the perfection requirements of the governing law of the receivables (in this case English law). In addition, certain principles of English law may apply to govern the relationship between the purchaser and the obligor and in any insolvency proceedings of the seller and/or obligor in England & Wales.

## 4 Asset Sales

- 4.1 Sale Methods Generally. In England & Wales, what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology – is it called a sale, transfer, assignment or something else?**

The most common method of selling receivables is by way of assignment (which can be equitable or legal). Other sale methods include creating a trust over the receivables (coupled with a power of attorney), creating a trust over the proceeds of the receivables, sub-participation (by a limited recourse loan to the seller in return for the economic interest in the receivables) and novation (a transfer of both the rights and obligations under the contract).

An outright sale of receivables may be described as a "sale" or "true sale", a "transfer" or an "assignment". "Assignment" most often indicates a transfer of rights, but not obligations, whilst "transfer" usually indicates a transfer of rights and obligations by novation. The term "security assignment" is often used to distinguish a transfer by way of security from an outright assignment.

- 4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?**

To perfect an assignment of receivables, express notice in writing is required to be given to the obligor. In order for an assignment to take effect in law, rather than equity, s.136 of the Law of Property Act 2015 (the LPA) provides that the assignment must be: (i) in writing and signed by the assignor; (ii) of the whole of the debt; and (iii) absolute and unconditional and not by way of charge. Where the sale of a receivable does not meet all of these requirements, it will take effect as an equitable assignment only and any subsequent assignment effected by the seller and notified to the obligor prior to the date on which the original assignment is notified to the obligor, will take priority.

A novation of receivables (pursuant to which both the rights and obligations are transferred) requires the written consent of the obligor as well as the transferor and transferee.

- 4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?**

The transfer requirements for promissory notes (and other negotiable instruments) are governed by the Bills of Exchange Act 1882, which provides that they are transferable by delivery (or delivery and endorsement).

Mortgage loans and their related mortgages may be transferred by assignment. With respect to a mortgage over real property, as well as the giving of notice, certain other formalities need to be complied with in order to effect a legal assignment, for example registration of the transfer at H.M. Land Registry as required by the Land Registration Act 2002. Most residential mortgage securitisations are structured as an equitable assignment of mortgage loans and their related mortgages to avoid the burden of giving notice to the mortgagors and registering the transfer. However, until notice has been given and the formalities satisfied, the rights of an assignee of

a mortgage may be adversely affected by dealings in the underlying property or the mortgage, as described in question 4.4 below.

See questions 8.1 to 8.4 below for specific regulatory requirements in relation to consumer loans.

Transfers of marketable securities in bearer form will be achieved by delivery or endorsement and, if in registered form, by registration of the transferee in the relevant register. Dematerialised marketable securities held in a clearing system and represented by book-entries may be transferred by debiting the clearing system account of the relevant seller and crediting the clearing system account of the purchaser (or, in each case, its custodian or intermediary).

Specific statutory requirements may also apply for assignments of receivables such as intellectual property rights and certain policies of insurance.

**4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors' consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Whether or not notice is required to perfect a sale, are there any benefits to giving notice – such as cutting off obligor set-off rights and other obligor defences?**

Assuming the receivable does not fall into a select category of contractual rights which are incapable of assignment (e.g. as a matter of public policy or because the rights are of a personal nature) then, in the absence of an express contractual prohibition on assignment, receivables may be assigned without notification to, or consent of, the obligor.

The absence of notice has certain implications as follows: (i) obligors may continue to discharge their debts by making payments to the seller (being the lender of record); (ii) obligors may set-off claims against the seller arising prior to receipt by the obligors of the notice of assignment; (iii) a subsequent assignee of (or fixed chargeholder over) a receivable without notice of the prior assignment by the seller would take priority over the claims of the initial purchaser; (iv) the seller may amend the agreement governing the terms of the receivable without the purchaser's consent; and (v) the purchaser cannot sue the obligor in its own name (although this is rarely an impediment in practice).

**4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective – for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?**

Whilst no particular form of notice is required, it must be in writing, given by the seller or the purchaser to the obligor, and must not be conditional. The notice does not need to give the date of the assignment, but to the extent that a date is so specified, it must be accurate. The main requirement is that the notice is clear that the obligor should pay the assignee going forward.

There is no specific time limit for the giving of notices set down in the LPA and notice can be given to obligors post-insolvency of the seller (including pursuant to an irrevocable power of attorney

granted by the seller) or of the obligor. The giving of such notice should not be prohibited by English insolvency law, although failure to give notice will have the effects set out in question 4.4 above.

**4.6 Restrictions on Assignment – General Interpretation.** Will a restriction in a receivables contract to the effect that "None of the [seller's] rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]" be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says "This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]" (i.e., the restriction does not refer to rights or obligations)? Is the result the same if the restriction says "The obligations of the [seller] under this Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]" (i.e., the restriction does not refer to rights)?

As a general matter, it is not possible under English law to transfer or assign the burden (i.e. obligations, as distinct from rights) under a contract without the consent of the obligor. Obtaining this consent constitutes a novation. A novation is not, strictly speaking, a transfer, but is the replacement of the old contract with an identical new contract between the new party and continuing party. Therefore, where a contract refers to the "assignment of an agreement", an English court would likely find that this refers either to a novation of the rights and obligations thereunder or an assignment of rights coupled with the sub-contracting of obligations from the purported assignor to the purported assignee.

As such, whilst the appropriate classification will ultimately be a question of construction on any given set of facts:

- (i) the first restriction (an explicit restriction on transfer or assignment of rights or obligations) would likely be interpreted as prohibiting a transfer of receivables by the seller to the purchaser (absent consent);
- (ii) the second restriction (an explicit restriction on transfer or assignment, but no explicit reference to rights or obligations) would likely be interpreted in the same way provided that, at the time the receivables contract was entered into, the intention of the seller and the obligor was to restrict both the transfer of the performance of the receivables contract (e.g. the right to require performance of the receivables contract) as well as the transfer of any rights and/or obligations under that contract (e.g. accrued rights of action or rights to receive payments); and
- (iii) the third restriction (explicit restriction on transfer or assignment of obligations but no explicit reference to rights) is more likely to be viewed as permitting a transfer of receivables by the seller to the purchaser.

See also questions 4.1 and 4.4 above.

**4.7 Restrictions on Assignment; Liability to Obligor.** If any of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables or "seller's rights" under the receivables contract, are such restrictions generally enforceable in England & Wales? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If England & Wales recognises restrictions on sale or assignment of receivables and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or tort, or on any other basis?

Restrictions on assignments or transfers of receivables are generally enforceable. If a contract is silent on assignability, then such contract

and the receivables arising thereunder will be freely assignable. In very limited circumstances, such as upon the death of an individual or in certain limited statutory transfers, assignment may take place by operation of law, overriding an express contractual provision prohibiting assignment. It may be possible to utilise a trust arrangement where non-assignment provisions within contracts would otherwise prevent assignment.

If an assignment is effected in breach of a contractual prohibition on assignment, although ineffective as between the obligor and the seller (to whom the obligor can still look for performance of the contract), such assignment may still be effective as between the seller and purchaser if in compliance with the governing law and explicit terms of the receivables purchase agreement. If the seller can establish that the obligor has accepted the assignment either through its conduct or by waiver (for example, by course of dealing) then the obligor may be estopped from denying the assignment, even where there is a contractual prohibition on assignment.

See also questions 4.1, 4.4 and 4.6 above.

**4.8 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?**

The sale document must describe the receivables (or provide for details of the receivables to be provided at the point of sale) with sufficient specificity that the receivables can be identified and distinguished from the rest of the seller's estate. For confidentiality reasons, it is atypical for obligors' names to be included in the information provided to the seller.

**4.9 Respect for Intent of Parties; Economic Effects on Sale. If the parties describe their transaction in the relevant documents as an outright sale and explicitly state their intention that it be treated as an outright sale, will this description and statement of intent automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?**

A transaction expressed to be a sale will be recharacterised as a secured financing if it is found to be a "sham", i.e. if the documents do not represent the true intentions between the parties and are intended to mask the true agreement. Irrespective of the label given to a transaction by the parties, the court will look at its substance and examine whether it creates rights and obligations consistent with a sale.

Case law has established a number of key questions to be considered when concluding that a transaction is a true sale rather than a secured financing:

- (i) Do the transaction documents accurately reflect the intention of the parties and are the terms of the transaction documents consistent with a sale as opposed to a secured financing?
- (ii) Does the seller have the right to repurchase the receivables sold?

- (iii) Does the purchaser have to account for any profit made on any disposition by it of the receivables?
- (iv) Is the seller required to compensate the purchaser if it ultimately realises the acquired receivables for an amount less than the amount paid?

However, a transaction may still be upheld as a sale notwithstanding the presence of one or more of these factors. As a result, the intention of the parties, their conduct after the original contract and the express terms of the contract are all factors a court will take into account, as a whole, when determining whether or not a contract is inconsistent with that of a sale.

The seller remaining the servicer/collection agent of the receivables post-sale, the seller entering into arm's-length interest-rate hedging with the purchaser, the seller assuming some degree of credit risk by assuming a first loss position and the right of a seller to repurchase receivables in limited circumstances are not generally considered to be inherently inconsistent with sale treatment. The seller retaining an equity of redemption in respect of a transfer of receivables may, however, lead a court to the conclusion that the transaction is a security arrangement rather than an outright transfer.

If the sale is recharacterised as a secured financing, the assets "sold" will remain on the seller's balance sheet and the loan will be treated as a liability of the seller. In addition, given the practice in England & Wales not to make "back-up" security filings, the security may not have been registered and may, therefore, be void in a seller insolvency for lack of registration (subject to the application of the FCR as referred to in question 5.3 below).

In addition to recharacterisation, sale transactions are also vulnerable under certain sections of the Insolvency Act 1986 such as those relating to transactions at an undervalue and preferences.

**4.10 Continuous Sales of Receivables. Can the seller agree in an enforceable manner to continuous sales of receivables (i.e., sales of receivables as and when they arise)? Would such an agreement survive and continue to transfer receivables to the purchaser following the seller's insolvency?**

An agreement pursuant to which a seller agrees to sell receivables on a continuous basis prior to the occurrence of certain specified events will take effect, as between the seller and purchaser, as an agreement to assign. The receivables will be automatically assigned to the purchaser as, and when, they come into existence.

See the answer to question 6.5 below on the effect of an insolvency of the seller on an agreement to assign a receivable not yet in existence.

**4.11 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., "future flow" securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller's insolvency?**

An assignment for value of an identifiable receivable, which is not in existence at the time of the receivables purchase agreement, but which will be clearly ascertainable in the future, is treated as an agreement to assign which will give rise to an equitable assignment of the receivable as soon as it comes into existence.

See the answer to question 6.5 below on the effect of an insolvency of the seller on an agreement to assign a receivable not yet in existence.

- 4.12 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?**

Security for a receivable will typically be capable of being assigned in the same manner as the receivable itself. The transfer or assignment of some types of security may require additional formalities such as registration or payment of a fee as referred to in question 4.3 above.

- 4.13 Set-Off; Liability to Obligor. Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor's set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor's set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?**

Generally speaking, an obligor's right to set-off (i) amounts owing to it from the seller, against (ii) amounts it owes to the seller, under that receivables contract will survive receipt of notice of a sale against the assignee of the receivables contract provided that the obligor's cross-debt arose before the obligor received notice of the sale. The assignee takes the benefit of the receivables contract subject to any rights of set-off in existence between the obligor and seller at the time the obligor receives notice of the sale.

If a cross-debt arises after the obligor has received notice of the sale, an obligor will generally be unable to set-off such cross-debt against the purchaser unless the claims of the obligor and the purchaser are sufficiently closely connected.

An obligor's right to set-off under a receivables contract may terminate if the cross-debt becomes unenforceable or time-barred. In the absence of a breach of any provision to the contrary, it is unlikely that either the seller or the purchaser would be liable to the obligor for damages as a result of an obligor's rights of set-off terminating by operation of law.

## 5 Security Issues

- 5.1 Back-up Security. Is it customary in England & Wales to take a "back-up" security interest over the seller's ownership interest in the receivables and the related security, in the event that an outright sale is deemed by a court (for whatever reason) not to have occurred and have been perfected?**

It is not customary to create "back-up" security over a seller's ownership interest in receivables and related security when an outright sale is intended although a seller may create a trust over the receivables in favour of the purchaser to the extent that any outright sale is held either not to have occurred or to be void, or is subsequently recharacterised.

- 5.2 Seller Security. If it is customary to take back-up security, what are the formalities for the seller granting a security interest in receivables and related security under the laws of England & Wales, and for such security interest to be perfected?**

See questions 5.1 above and 5.3 below.

- 5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in England & Wales to grant and perfect a security interest in purchased receivables governed by the laws of England & Wales and the related security?**

Although security may be taken over receivables by way of novation, attornment, pledge (in the case of documentary receivables capable of being delivered) or by retention of title arrangements, security is most commonly taken over receivables by way of mortgage or charge.

Receivables assigned by way of security together with a condition for re-assignment on redemption or discharge of the secured obligation will create a mortgage over the receivables which will either be legal (if the procedural requirements of the LPA identified in question 4.2 above are satisfied) or, in the absence of these requirements (or where the subject property is not currently owned or in existence), equitable. Prior to the perfection of an equitable mortgage, the assignee's security will be subject to prior equities (such as rights of set-off and other defences), will be liable to take priority behind a later assignment where the later assignee has no notice of the earlier assignment and himself gives notice to the obligor, and the obligor will be capable of making good discharge of its debt by paying the assignor directly (see questions 4.4 and 4.5 above).

Alternatively, the receivables may be made the subject of a fixed or floating charge. In comparison to a mortgage (which is a transfer of title together with a condition for re-assignment on redemption) a charge is a mere encumbrance on the receivables, giving the chargee a preferential right to payment out of the fund of receivables in priority to other claimants. A practical distinction between a mortgage and a charge over receivables is the inability of a chargee to claim a right of action in his own name against the obligor. In practice this distinction is diminished by including a right to convert the charge into a mortgage together with a power of attorney to compel transfer of the receivables to the chargee. Additionally, the statutory rights conferred by Section 101 of the LPA allowing the chargee to appoint a receiver in respect of charges created by deed and the other rights provided to holders of some "qualifying floating charges", provide further enforcement rights for a charge.

The degree of priority given to a chargee depends on whether the charge is fixed or floating. Whilst definitive definitions have remained elusive, the hallmarks of a fixed charge are that it attaches to the ascertainable receivables over which it is subject immediately upon its creation (or upon the receivable coming into existence). In comparison, a floating charge is a present security over a class or fund of assets (both present and future) which, prior to the occurrence of a specified crystallisation event, can continue to be managed in the ordinary course of the chargor's business. On the occurrence of a specified crystallisation event the floating charge will attach to the assets then presently in the fund, effectively becoming a fixed charge over those assets. Recent case law emphasises control of

the receivable as the determining factor in distinguishing a fixed or floating charge whilst asserting that it is the substance of the security created, rather than how described or named, that is important.

The distinction is important: on an insolvency of the chargor, a fixed chargeholder will rank in priority to all unsecured claims whilst a floating chargeholder will rank behind preferential creditors and fixed chargeholders and equally with a statutory “prescribed part” (up to a maximum of £600,000) made available to unsecured creditors; a floating charge given within 12 months (or 24 months if given to a “connected” person) prior to the onset of insolvency will be void except as to new value given; and whereas a fixed chargeholder will obtain an immediate right over definitive assets which can only be defeated by a purchaser in good faith of the legal interest for value without notice of the existing charge (and, as summarised below, as most charges will be registrable or in practice registered, many purchasers will be held to have notice of such charge accordingly), in contrast, disposing of an asset subject to an uncristallised floating charge will, apart from certain exceptions, generally result in the purchaser taking the receivables free of the charge.

For charges or mortgages created by an English company (or LLP) on or after 6 April 2013, there is a registration regime allowing (with some very limited exceptions) the chargor or anyone interested in the charge to register (including in some cases electronically) within 21 calendar days (beginning with the day following the creation of a charge) with the registrar of companies at the registry for companies incorporated in England & Wales (**Companies House**), a statement of particulars of that charge in order to avoid the charge becoming void for lack of registration. This regime applies whether the charge is over an asset in or outside the UK. A different regime applies to charges created by English companies: (i) if the charge was created before 1 October 2009 (whereby the Companies Act 1985 (**CA 1985**) applies); and/or (ii) if the charge was created on and from 1 October 2009 but before 6 April 2013 (whereby the Companies Act 2006 (the **CA 2006**, and together with the CA 1985, the **Companies Act**) applies) under which regimes certain categories of charge had to be registered at Companies House.

For charges created by overseas companies over UK property on or after 1 October 2011, there is no requirement to register such charges at Companies House. A different regime applies to charges created by overseas companies: (i) if the charge was created before 1 October 2009 (whereby the CA 1985 applies); and/or (ii) if the charge was created on and from 1 October 2009 to and on 30 September 2011 (whereby the CA 2006 and the Overseas Companies (Execution of Documents and Registration of Charges) Regulations 2009 applies).

Where certain security arrangements exist over financial collateral (cash, financial instruments and credit claims) between two non-natural persons, the Financial Collateral Arrangements (No. 2) Regulations 2003 (as amended, including pursuant to the Financial Markets and Insolvency (Settlement Finality and Financial Collateral Arrangements) (Amendments) Regulations 2010 that came into force in England & Wales on 6 April 2011) (the **FCR**) which implement EU Directive 2002/47/EC into English law, disapply certain statutory requirements in relation to that security arrangement (such as the requirement to register security at Companies House under the CA 2006 or overseas companies registration requirements noted above as well as certain provisions of English insolvency law).

Except as noted above with regard to the FCR, failure to register a registrable charge within the prescribed statutory period will (both pre and post 6 April 2013) result in that security interest being void as against a liquidator, administrator, creditors in a liquidation or administration or secured creditors. As such, and notwithstanding the potential application of the FCR and the voluntary registration

regime from 6 April 2013, mortgages and charges, whether clearly within the categories listed in the Companies Act or potentially financial collateral arrangements, are habitually registered at Companies House. As registration of a charge is a perfection requirement (and not a requirement for attachment of security) an unregistered charge will still be valid as against the chargor, provided the chargor is not in winding-up or administration. Similarly, registration under the Companies Act is not determinative as to priority such that, provided that both charges are registered within the statutory 21-day period after creation, a prior created charge will take priority over a subsequently created charge even where that prior charge is registered second.

#### **5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of England & Wales, and that security interest is valid and perfected under the laws of the purchaser's country, will it be treated as valid and perfected in England & Wales or must additional steps be taken in England & Wales?**

Notwithstanding the choice of law governing the purchaser's security, the law governing the receivable itself will govern the proprietary rights and obligations between the security holder and the obligor and between the security granter and the security holder (including as to matters of validity, priority and perfection).

The relevant security must therefore be valid and perfected under the laws of England & Wales as well as valid and perfected under the laws of the governing law of the security in order for it to be given effect by the English courts. In addition, English courts will also apply certain mandatory rules of English law which may affect the validity of any foreign law governed security created.

#### **5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?**

Security over contractual rights under insurance policies is usually created by security assignment. Security over mortgage or consumer loans will be created by mortgage or charge. Creating security over the mortgage securing a mortgage loan is generally accomplished by equitable mortgage.

Security over marketable debt securities or negotiable instruments (including promissory notes and bearer debt securities) is a complicated area that depends on whether the relevant securities are bearer or registered, certificated, immobilised (i.e. represented by a single global note) or dematerialised and/or directly-held or indirectly-held. In (brief) summary: (i) directly-held and certificated debt securities, where registered, may generally be secured by legal mortgage (by entry of the mortgagee on the relevant register) or by equitable mortgage or charge (by security transfer or by agreement for transfer or charge); (ii) security over bearer debt securities may be created by mortgage or pledge (by delivery together with a memorandum of deposit) or charge (by agreement to charge) and in certain limited circumstances a lien may arise; and (iii) security may be created over indirectly-held certificated debt securities by legal mortgage (by transfer, either to an account of the mortgagee at the same intermediary or by transfer to the mortgagee's intermediary or nominee via a common intermediary) or by equitable mortgage or charge (by agreement of the intermediary to operate a relevant securities account in the name of the mortgagor containing the debt securities to the order/control of the chargee).

The FCR (which remove certain requirements in relation to the creation and registration of security and disapply certain rules of insolvency law) will apply to any security which is a “financial collateral arrangement” involving “financial collateral”. See question 5.3 above.

**5.6 Trusts. Does England & Wales recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller's own assets until turned over to the purchaser?**

Trusts over collections received by the seller in respect of sold receivables are recognised under the laws of England & Wales provided that the trust is itself validly constituted.

**5.7 Bank Accounts. Does England & Wales recognise escrow accounts? Can security be taken over a bank account located in England & Wales? If so, what is the typical method? Would courts in England & Wales recognise a foreign law grant of security taken over a bank account located in England & Wales?**

English law recognises the concept of money held in a bank account in escrow. Security granted by a depositor for a third party is typically taken over the debt represented by the credit balance by way of charge or (where the securityholder is not also the same bank at which the cash is deposited) a security assignment. Security over a credit balance granted in favour of the bank at which the deposit is held can only be achieved by way of charge (not by assignment) and is usually supplemented by quasi-security such as a flawed asset arrangement, a contractual right of set-off and/or a charge in favour of the bank over the depositor's claims for payment of the deposit. To the extent that the security is a security financial collateral arrangement over cash, as provided for in the FCR, those regulations will apply. The security interest is habitually perfected by registration, as mentioned in question 5.3 above.

Foreign-law governed security over a bank account located in England & Wales must be valid under the laws of England & Wales as well as its own governing law in order for it to be given effect by the English Courts.

**5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?**

This is a complicated question that will depend upon (amongst other things) the nature of the security over the account (whether on its facts it is a fixed or floating charge or a security assignment), whether there are any competing security interests or trust arrangements over the account and the extent of any commingling of cash, whether any security interest is also a security financial collateral arrangement under the FCR and whether the account holder is the subject of insolvency proceedings. Where a security financial collateral arrangement under the FCR exists, the parties may agree the collateral-taker can appropriate the financial collateral, giving the right to become the absolute owner of the collateral should the security become enforceable.

**5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?**

Any charge over the account is likely to be a floating charge rather than a fixed charge on these facts because the chargee is unlikely to have sufficient control over the account in order to create a fixed charge. The ramifications of this distinction are set out in question 5.3 above.

Whether an English law floating charge can be a security financial collateral arrangement under the FCR (with the advantages that this may bring to a chargeholder) has been the subject of recent case law focusing on the FCR requirement that the charged collateral be in the “possession” and “control” of the collateral-taker. In early 2013, the Financial Markets Law Committee, established by the Bank of England, published a paper urging clarification, but until further judicial or legislative clarification is provided surrounding the level of rights the collateral provider can retain (i.e. what is the detailed meaning of “rights of substitution” and “withdrawal of excess”, which if retained by the collateral provider will not be fatal to the classification of the security as a financial collateral arrangement), there is currently no definitive answer on whether an English law floating charge will constitute a security financial collateral arrangement.

## 6 Insolvency Laws

**6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will the insolvency laws of England & Wales automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? If so, what generally is the length of that stay of action? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?**

Most formal insolvency procedures have an automatic stay of action against the insolvent entity. The stay will typically apply for the duration of the proceeding from the time it is effective, unless the court grants leave to lift the stay. An automatic interim moratorium applies between the instigation of administration proceedings and the company entering administration. However, on a winding up petition, no interim moratorium applies until the court grants a winding-up order unless a provisional liquidator is appointed.

If the right to the receivables has been transferred by legal assignment, the sale will be perfected, the purchaser will have the right to enforce his assigned rights in his own name and a stay of action on the insolvency of the seller should not affect the purchaser's ability to collect income from the receivables.

If the seller is appointed as servicer for the receivables, the stay of action may prevent the purchaser from taking action to enforce the servicing contract and any proceeds held by the servicer other than in a binding trust arrangement may be deemed to be the property of the servicer, not the purchaser.

If the receivables have been sold by equitable assignment and notice has not been given to an obligor, such obligor may continue to pay the seller. Typically, such proceeds will be subject to a trust in favour of the purchaser. If such a trust has not been imposed on the collections, the purchaser will be an unsecured creditor with respect to such collections.

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**6.2 Insolvency Official's Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser's exercise of rights (by means of injunction, stay order or other action)?**

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Assuming the receivables have been sold by legal assignment or perfected equitable assignment, an insolvency official appointed over the seller would not be able to prohibit the purchaser's exercise of its rights, unless there had been fraud or another breach of duty or applicable law (such as the antecedent transaction regime described in question 6.3 below).

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**6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the insolvency proceeding? What are the lengths of the "suspect" or "preference" periods in England & Wales for (a) transactions between unrelated parties, and (b) transactions between related parties?**

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The insolvency official would need a court order to reverse an antecedent transaction, except for a disposition of property made after a winding-up petition has been presented (assuming a winding-up order is subsequently made). Such dispositions are void and any receivables purportedly transferred during that period would remain the property of the seller.

Otherwise, the court may set aside a transaction made at an undervalue in the two years ending with the commencement of the administration or liquidation if the company was, at that time, or as a result of the transaction became, unable to pay its debts as they fell due. There is a defence if the court is satisfied that the company entered into the transaction in good faith with reasonable grounds for believing that it would benefit the company. If a transaction at an undervalue is done with the purpose of putting assets beyond the reach of creditors, there is no requirement to prove contemporaneous insolvency and no time limit for bringing court proceedings.

A transaction which puts a creditor or guarantor of the seller into a better position (in a winding-up) than it would otherwise have been in had that transaction not occurred can be set aside by the court if such preference is made: (i) in the two years ending with the onset of insolvency (in the case of a preference to a person "connected" with the company); or (ii) in the six months prior to insolvency (in the case of any other preference). It is necessary to show that a preference was made with a desire to prefer the creditor or guarantor.

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**6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?**

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The equitable remedy of substantive consolidation, which permits the court to treat the assets and liabilities of one entity as though they

were those of another, is not recognised by the English courts. Only in circumstances where the assets and liabilities of two companies were indistinguishably amalgamated together, and where to do so would be in the interests of both companies' creditors, might the court sanction an arrangement reached by the insolvency official and those creditors.

It is a fundamental principle of English law that a company has a legal personality distinct from its shareholders (a 'corporate veil') emanating from the House of Lords decision in *Salomon v A Salomon & Co Ltd* [1897] AC 22. The separate legal personality of a company will only be ignored in very limited circumstances. Examples include fraud, illegality, where a company is formed to evade contractual obligations or defeat creditors' claims or where an agency or nominee relationship is found to exist.

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**6.5 Effect of Insolvency on Receivables Sales. If insolvency proceedings are commenced against the seller in England & Wales, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings, or (b) on sales of receivables that only come into existence after the commencement of such proceedings?**

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Where the receivables purchase agreement provides that no further action is required by the seller for the receivables (including receivables arising in the future) to be transferred, the agreement will generally continue to be effective to transfer the receivables even after the initiation of insolvency proceedings. However, either party could exercise a contractual right to terminate.

Further, in certain circumstances, a liquidator might be able to disclaim (and thereby terminate) an ongoing receivables purchase agreement if it were an "unprofitable contract". Where the agreement requires further action from the seller, the insolvency official may choose not to take that action and, in that situation, the purchaser's remedy is likely to be limited to an unsecured claim in any insolvency proceedings.

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**6.6 Effect of Limited Recourse Provisions. If a debtor's contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?**

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Historically, it has generally been understood that provisions providing that creditors only have limited recourse to the assets of a debtor would be effective in making the debtor insolvency-remote provided that, on the face of the contractual documents, this was the clearly expressed intention of the parties.

However, on a recent unopposed application by a debtor to initiate insolvency proceedings (*ARM Asset Backed Securities S.A. [2013] EWHC 3351 (Ch)* (9 October 2013) (**ARM**)), the debtor was held to be insolvent in spite of the fact that its debts were limited in recourse (although the court did not question the provision's effectiveness as a matter of contract).

The judgment has been the subject of much debate and is capable of being limited to its context on a number of factual and legal grounds, but as a result it is currently unclear as to whether an English court would come to a similar conclusion on an opposed and fully argued application.

## 7 Special Rules

**7.1 Securitisation Law.** Is there a special securitisation law (and/or special provisions in other laws) in England & Wales establishing a legal framework for securitisation transactions? If so, what are the basics?

Other than certain tax laws (see question 9.2 below in relation to special purpose entities which are “securitisation companies” and their treatment for tax purposes), there are no laws specifically providing for securitisation transactions.

**7.2 Securitisation Entities.** Does England & Wales have laws specifically providing for the establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

There are no laws specifically providing for the establishment of special purpose entities for securitisation (although see question 9.2 below in relation to special purpose entities which are “securitisation companies” and their treatment for tax purposes).

**7.3 Limited-Recourse Clause.** Will a court in England & Wales give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?

Provisions limiting the recourse of a creditor to the net proceeds of disposal or enforcement of specified assets owned by the obligor or its available funds are likely to be valid under English law and an English court is likely to hold that, to the extent of any shortfall, the debt of the obligor is extinguished. Whilst the ARM case referenced in question 6.6 above brought into question whether a limited recourse provision will be effective to prevent a debtor being held unable to pay its debts, with the judge stating that the way of testing whether a company is insolvent is to consider the amounts for which bondholders would prove in a liquidation (being the face value of, and interest payable on, the bonds), the judge also confirmed the effectiveness of a limited recourse provision as a matter of contract, stating that “the rights of the creditors to recover payment will be, as a matter of legal right as well as a practical reality, restricted to the available assets, and ... the obligations [of the debtor] will be extinguished after the distribution of available funds”. In the recent case of *Titan Europe 2006-3 plc v Colliers International UK (in liquidation)* [2014] EWHC 3106 (Comm), which is currently being appealed, the court held that the SPV was the correct claimant as it had suffered the relevant loss, not the noteholders, and the limited recourse provisions were irrelevant in making such determination.

Where the agreement is governed by a law of another country and the English courts have cause to consider its efficacy under that foreign law, the analysis as to whether such a clause would be upheld will be the same as that discussed in questions 3.4 and 3.5 above, namely that the English courts would apply the foreign governing law to determine whether the limited recourse provision was effective.

**7.4 Non-Petition Clause.** Will a court in England & Wales give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

Non-petition clauses are likely to be valid under English law, although there is little authority. The most effective method for enforcing such a clause would be injunctive relief which, as an equitable remedy, is at the discretion of the court. A court will exercise its discretion and would have to consider whether such a clause was contrary to public policy as an attempt to oust the jurisdiction of the court or English insolvency laws. It is possible that an English court would deal with a winding-up petition even if it were presented in breach of a non-petition clause. A party may have statutory or constitutional rights to take legal action against the purchaser or such other person which are not possible to be contractually disappled. Where the agreement is governed by a law of another country and the English courts have cause to consider its efficacy under that foreign law, the analysis as to whether such a clause would be upheld will be the same as that discussed in questions 3.4 and 3.5 above, namely that the English courts would apply the foreign governing law to determine whether the non-petition clause was effective.

**7.5 Priority of Payments “Waterfall”.** Will a court in England & Wales give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

In respect of English law governed priorities of payments, as a general matter, the courts of England & Wales will seek to give effect to contractual provisions that sophisticated commercial parties have agreed, except where to do so is contrary to applicable law or public policy.

The English Supreme Court decision in *Belmont Park Investments Pty Limited v BNY Corporate Trustee Services Ltd and Lehman Brothers Special Financing Inc.* [2011] considered whether a contractual provision subordinating a party's rights to payment on the occurrence of an insolvency event (termed a ‘flip clause’) was contrary to applicable English law, specifically the “anti-deprivation” and the “*pari passu*” rules (two sub-sets of a general principle that parties should not contract out of insolvency legislation). The judgment (in which the payment priorities were upheld notwithstanding the fact that the subordination provision was triggered by insolvency of the creditor) put particular emphasis, in deciding whether to give effect to the relevant provisions, on the importance of party autonomy and the desire of the courts to give effect to agreed contractual terms, as well as consideration of whether the relevant subordination provisions were commercially justifiable and entered into in good faith, or whether they evidenced an intention to evade insolvency laws.

By contrast, the U.S. Bankruptcy Court has held in parallel proceedings that the English law governed “flip clause” in question was unenforceable as a violation of the U.S. Bankruptcy Code, resulting in competing decisions in the UK and the U.S. and in uncertainty as to whether an adverse foreign judgment in respect of the enforceability of a priority of payments “waterfall” would be recognised and given effect by the English courts in the context of a cross-border insolvency case. An English Supreme Court judge has acknowledged that in the absence of clear authority, it is for the English parliament to legislate to invalidate such clauses.

Where the priority of payments is governed by a law other than the laws of England & Wales and the English courts have cause to consider its efficacy under that foreign law, the analysis as to whether such a clause would be upheld will be the same as that discussed in questions 3.4 and 3.5 above, namely that the English courts would apply the foreign governing law to determine whether the priority of payments was effective.

**7.6 Independent Director. Will a court in England & Wales give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?**

The articles of association of a company or a contract entered into by a company may, in principle, restrict the authority of directors but a restriction or limitation on the ability of the directors to bring insolvency proceedings may be invalid as a matter of public policy or incompatible with certain statutory duties of the directors.

## 8 Regulatory Issues

**8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in England & Wales, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in England & Wales? Does the answer to the preceding question change if the purchaser does business with other sellers in England & Wales?**

A purchaser of consumer receivables may require authorisation under FSMA, by the FCA. However, there are certain, limited exemptions available where a purchaser enters into a servicing agreement with an appropriately authorised third party in relation to the receivables, and certain other criteria are met. A purchaser of residential mortgage loans who assumes a servicing and collection role with respect to such mortgage loans will also require authorisation from the FCA. The purchaser will also be obliged to register under the Data Protection Act 1998 (the **DPA**). It makes no difference whether or not the purchaser does business with other sellers in England and Wales.

**8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?**

The seller is likely to need permission from the FCA to conduct regulated activities such as debt collection and registration under the DPA. Where the seller continues to act as servicer with respect to second charge residential mortgage loans which are captured by consumer credit legislation (first charge mortgage credit is subject to a separate FCA regime) it will be required to be authorised to perform such a role by the FCA. Any standby or replacement servicer will require the same authorisations, before taking any action to enforce or collect monies owed under regulated credit agreements.

**8.3 Data Protection. Does England & Wales have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?**

The handling and processing of information on living individuals is regulated by the DPA. The DPA only applies to personal data, so it affects data on individual living obligors and not enterprises. The DPA specifies that a data controller is any legal person who determines the purposes for which, and the manner in which, any personal data is to be processed, and so may well include a purchaser of receivables serviced by the seller. A data controller in the UK must register (known as notification) with the Information Commissioner's Office unless limited exemptions apply.

**8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of England & Wales? Briefly, what is required?**

Performance of certain functions in relation to regulated consumer credit, including second charge mortgages or consumer hire agreements, requires permission from the FCA (e.g. exercising, or having the rights to exercise the lender's rights and duties under a regulated credit agreement).

The CCA (and delegated legislation thereunder) also continues to apply to consumer credit agreements, and contains several important requirements for lenders/owners under regulated consumer credit/hire agreements. In addition to the requirements of the CCA, firms authorised under FSMA to carry on consumer credit lending must comply with the FCA's Handbook, including its consumer credit sourcebook, 'CONC'. These rules are aimed at ensuring the fair treatment of consumers, and contain prescriptive rules and guidance relating to all aspects of the loan lifecycle, including in relation to arrears management.

The UTCCR applies to agreements made on or after 1 July 1995. A term is "unfair" if it causes a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer. Such an unfair term will not be binding on the consumer.

The Unfair Contracts Terms Act 1977 restricts the limitation of liability by a party. Liability for death or personal injury caused by negligence cannot be limited and any clauses that limit liability for other damage caused by negligence must satisfy a reasonableness test.

Mortgage contracts are regulated by FSMA. Entering into a regulated mortgage contract, arranging or administering it or advising on it is a regulated activity, requiring authorisation from the FCA under FSMA. First charge mortgage lenders authorised under FSMA are required to comply with the FCA's Mortgages: Conduct of Business handbook, 'MCOB'.

The Consumer Rights bill seeks to harmonise domestic legislation in relation to consumer protection legislation in the UK. The current draft of the bill contains important provisions relating to unfair contract terms.

**8.5 Currency Restrictions. Does England & Wales have laws restricting the exchange of the currency of England & Wales for other currencies or the making of payments in the currency of England & Wales to persons outside the country?**

No, subject to any restrictions imposed by United Nations sanctions.

## 9 Taxation

- 9.1 Withholding Taxes.** Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in England & Wales? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located? In the case of a sale of trade receivables at a discount, is there a risk that the discount will be recharacterised in whole or in part as interest? In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest?

The withholding tax treatment of UK receivables depends not only on their nature but on the nature of the recipient to whom they are paid. Very broadly, payments of interest with a UK source may be paid without withholding to a purchaser which is either resident in the UK or carries on business in the UK through a permanent establishment. Payments of interest to a non-UK resident purchaser may often be subject to withholding subject to any available treaty relief pursuant to a double taxation convention. Generally (except in the case of large serviced static pools of assets where there have been some recent administrative advances for unrated deals) the use of relief under a double taxation convention where there are multiple assets may be administratively challenging. Accordingly loan receivables are typically securitised through the use of a UK resident purchasing company.

Generally trade receivables payments and lease rental payments are not subject to UK withholding unless they provide for the payment of interest, in which case the interest element will be subject to withholding in the same way as interest on loan relationships. The recharacterisation of deferred purchase price as interest depends upon the facts of the case in question, but is not a typical outcome under the UK rules.

- 9.2 Seller Tax Accounting.** Does England & Wales require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

The tax treatment of a company within the charge to UK corporation tax would be expected, at least as a starting point, to follow its accounting treatment. For a company purchasing receivables, in many cases the rules imposed by the appropriate accounting regime would be expected to result in the creation of accounting profits, and accordingly taxable profits, which do not reflect the actual cash position of the company in question.

For accounting periods commencing on, or after, 1 January 2007, the Taxation of Securitisation Companies Regulations have been in force. These regulations apply to companies which are “securitisation companies” (as defined in the regulations) and permit a securitisation company to be subject to tax treatment reflecting the cash position of its securitisation arrangements such that it is taxed only on the cash profit retained within the company after the payment of its transaction disbursements according to the transaction waterfall. As such, balanced tax treatment can be achieved and the regime has been seen as providing effective relief from the complex or anomalous tax rules which could otherwise apply to UK incorporated special purpose vehicles.

- 9.3 Stamp Duty, etc.** Does England & Wales impose stamp duty or other documentary taxes on sales of receivables?

Stamp duty exists in the UK and is chargeable on documents in certain circumstances. Transactions may also be subject to UK Stamp Duty Reserve Tax (**SDRT**) levied on transfers of certain types of securities whether effected by document or otherwise. Generally, transfers of loans (which are not convertible and have no “equity” type characteristics such as profit-related interest), trade and lease receivables should not be subject to UK stamp duty or SDRT.

- 9.4 Value Added Taxes.** Does England & Wales impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

UK value added tax (**VAT**) is chargeable on supplies of goods and services which take place in the UK and which are made by “taxable persons” in the course or furtherance of a business. The standard rate of VAT is currently 20%, although certain supplies (including the supply of certain financial services) are exempt from VAT.

In *MBNA Europe Bank Ltd v HMRC* [2006] it was decided by the UK High Court that the transfer of credit card receivables by an originator in a securitisation was not a supply for VAT purposes. However, that decision may not apply to all such transfers. To the extent that the decision does not apply, a transfer of financial receivables would generally be treated as an exempt supply for VAT purposes if made in the UK for VAT purposes, and outside the scope of VAT if made outside the UK for VAT purposes.

Generally, fees payable for collection agent services are not exempt from VAT and will usually give rise to VAT at the standard rate, to the extent they are treated as taking place in the UK.

- 9.5 Purchaser Liability.** If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

As described above, the transfer of financial receivables would usually either constitute an exempt supply for VAT purposes, or fall outside the scope of VAT altogether. However, a UK seller might incur VAT on a supply of assets which does not fall within any of the exemptions: for example, property or trading assets on a true sale securitisation. If so, the UK seller would generally be liable to account for such VAT to H.M. Revenue & Customs (**HMRC**).

Broadly, HMRC would not be able to require the purchaser to account for VAT unless the purchaser was a member of the same group as the seller for VAT purposes. Although there are limited exceptions to this general position, it is unlikely that such exceptions would apply in a securitisation context.

Where charged, stamp duty and SDRT are generally payable by the purchaser.

**9.6 Doing Business. Assuming that the purchaser conducts no other business in England & Wales, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in England & Wales?**

Generally, the purchase of receivables will not give rise to tax liabilities for a purchaser conducting no other business in the UK, and the appointment of a servicer by the purchaser which carries out normal administrative activities on its behalf should not result in tax liabilities for the purchaser. The question of enforcement is more complex and the particular circumstances would need to be considered carefully.

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Rupert advises arrangers, originators and investors on all aspects of securitisation, structured finance and derivatives as well as advising counterparties in relation to general capital markets issuances, asset backed and leveraged finance transactions and portfolio sales.

Rupert is recognised in legal directories as "one of the brightest young partners in the market" and as "responsive, commercially minded" with "considerable experience and talent". He is recognised as a Leading Individual for Securitisation and recommended for Derivatives & Structured Products in Legal 500 UK 2014. He is also the author of a number of academic and commercial guides to Securitisation.

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Jacky has been practising in the London finance market since the mid-eighties and has represented financial institutions, hedge funds and private equity houses on a variety of finance transactions including leveraged finance, asset backed lending, real estate lending, securitisation, derivatives and restructuring and was one of a handful of lawyers involved in the development of the UK securitisation market. She has represented both banks and corporate clients in connection with the securitisation of a number of asset types including ports revenues, residential mortgages, commercial real estate, trade receivables, credit cards, computer/equipment leases, auto loans, hire purchase receivables and music royalties as well as football ticket and stadium financing.

In addition, Jacky has advised financial institutions, private equity clients and hedge funds on acquisition finance, the restructuring of complex structured finance transactions, the acquisition and disposal of distressed portfolios of financial assets and the unwinding of vast and complex derivatives portfolios.

Jacky is recognised as a Leading Lawyer for Structured Finance and Securitisation in IFLR 1000 UK 2015 and for Securitisation in Legal 500 UK 2014. She is listed as a Leading Individual for Securitisation and Structured Finance & Derivatives in Chambers UK 2015 with clients noting she is "very commercial, incredibly smart, and represents our interests with other counsel, bringing them round to our point of view in a non-confrontational way".

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